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UNITED STATES COPYRIGHT ROYALTY JUDGES

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IN THE MATTER OF: )

)

DETERMINATION OF RATES ) Docket No.

AND TERMS FOR MAKING AND ) 16-CRB-0003-PR

DISTRIBUTING PHONORECORDS ) (2018-2022)

(PHONORECORDS III), )

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8 DISTRIBUTING PHONORECORDS) (2018-2022)

9 (PHONORECORDS III), )

10 -----X

11 BEFORE: THE HONORABLE SUZANNE BARNETT

12 THE HONORABLE JESSE M. FEDER

13 THE HONORABLE DAVID R. STRICKLER

14 Copyright Royalty Judges

15

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## 1 P R O C E E D I N G S

2 (9:08 a.m.)

3 JUDGE BARNETT: Housekeeping? We have  
4 studied our calendar and all of the pieces of the  
5 puzzle, and could hear closing arguments in this  
6 case on the 8th of June. If that turns out to be  
7 the subject of irreconcilable calendar problems, we  
8 have the 6th or the 7th. And if none of those days  
9 work, let us know. Thank you.

10 MR. ASSMUS: Your Honors, Spotify recalls  
11 Dr. Leslie Marx.

12 JUDGE BARNETT: Thank you. Good morning.  
13 You remain under oath, Dr. Marx.

14 THE WITNESS: Thank you.  
15 Whereupon--

16 LESLIE MARX  
17 a witness, called for examination, having previously  
18 been duly sworn, was examined and testified further  
19 as follows:

20 DIRECT EXAMINATION

21 BY MR. ASSMUS:

22 Q. Good morning, Dr. Marx.

23 A. Good morning.

24 Q. Could you reintroduce yourself to the  
25 Panel?

1           A.    I'm Leslie Marx.  I'm a professor at Duke  
2 University, and I spoke to you about my written  
3 direct testimony earlier.

4           MR. ASSMUS:  And I'd remind the Panel  
5 that Dr. Marx was previously qualified as an expert  
6 in economics and industrial organization.

7           JUDGE BARNETT:  Yes, thank you.

8 BY MR. ASSMUS:

9           Q.    You should have in front of you, and the  
10 Panel will have shortly, a binder.  And the first  
11 tab of that binder is Spotify Trial Exhibit 1069.  
12 Could you turn to it?

13          A.    I see that.

14          Q.    And could you tell the Court what that  
15 is?

16          A.    This is my written rebuttal testimony.

17                JUDGE STRICKLER:  We have those binders.

18                MR. ASSMUS:  You do?

19                JUDGE STRICKLER:  Yes.

20                MS. ASSMUS:  Okay, perfect.

21 BY MR. ASSMUS:

22          Q.    Could you turn to the page immediately  
23 following numbered page 91?

24          A.    Yes.

25          Q.    And is that your signature?



1 A. Yes, it is.

2 MR. ASSMUS: Your Honor, we'd move for  
3 the admission into evidence of Trial Exhibit 1069,  
4 her written rebuttal testimony.

5 JUDGE BARNETT: 1069 is admitted.

6 (Pandora Exhibit Number 1069 was marked  
7 and received into evidence.)

8 BY MR. ASSMUS:

9 Q. Dr. Marx, could you briefly describe your  
10 role in the rebuttal phase of this proceeding?

11 A. I was asked to respond to the Copyright  
12 Owners' experts' written direct testimony, and I  
13 focused on the testimony of the economists, as  
14 Drs. Gans, Eisenach, and Rysman.

15 Q. And you've watched some of the testimony  
16 in this proceeding as well?

17 A. Yes, sir.

18 Q. Have you seen any evidence during the  
19 course of this proceeding, including the testimony  
20 of the Copyright Owners' economic experts, that  
21 causes you to change any of the conclusions you  
22 reached in either your written direct or your  
23 written rebuttal testimony?

24 A. No, I have not.

25 Q. Now, did you use some Spotify data in

1 connection with your rebuttal testimony?

2 A. I did. I was able to update some of the  
3 calculations to go from -- instead of just 2015,  
4 from the last -- the full year from the last half of  
5 2015 to the first half of 2016.

6 Q. And are the sources of Spotify data that  
7 you relied upon cited in your report?

8 A. Yes, they are.

9 Q. And have you prepared some slides in  
10 connection with your testimony today?

11 A. Yes, I have.

12 Q. And if you could turn to Demonstrative 2,  
13 before we get into the details of your work and your  
14 findings, I'm hoping you could provide the Panel  
15 with an overview of your rebuttal conclusions.

16 A. Yes. The Copyright Owners' proposal  
17 changes the structure and rates -- the structure of  
18 rates and substantially increases their level. The  
19 flat per-stream per-user structure particularly  
20 penalizes services targeting low-willingness-to-pay  
21 consumers, and mechanical royalties more than double  
22 for other services as well. And despite these  
23 changes, the Copyright Owners' experts opine that  
24 the Copyright Owners' proposal is reasonable and  
25 meets the 801(b) factors.

1           And as I explain in my written rebuttal  
2 testimony, the Copyright Owners' economists ignore  
3 or misinterpret the 801(b) factors. The Copyright  
4 Owners' economists provide misleading analyses.  
5 They haven't shown any ill effects of the current  
6 system. Publisher royalties are increasing with the  
7 rise of interactive streaming. A wide variety of  
8 interactive streaming services compete today, with  
9 associated customer benefits, and there's no  
10 evidence of depressed musical works production.

11           Q.   On that last point, no evidence of  
12 depressed musical works production, if there were  
13 such a depression, what would you expect to see in  
14 the market?

15           A.   I would expect to see a reduction in the  
16 number of songwriters and songs being produced, for  
17 example.

18           Q.   And you haven't seen evidence of that?

19           A.   I have not seen evidence of that.

20           Q.   You also mentioned that publisher  
21 royalties are increasing with the rise of  
22 interactive streaming. How is that important to  
23 your economic analysis?

24           A.   That tells me that the benefits of the  
25 increased move towards interactive streaming are --

1 are falling through to the publishers now in the  
2 form of increased publisher royalties.

3 Q. And I'd ask you to briefly describe your  
4 understanding of the Copyright Owners' proposal.

5 A. Yes. I prepared a slide on this. The  
6 Copyright Owners' proposal has all Services paying  
7 the same amount for every stream, regardless of  
8 length, and every user, regardless of the service  
9 characteristics. And the proposal is that the  
10 mechanical royalty would be the greater of .0015  
11 dollars per play and \$1.06 per end user.

12 And just to provide a little bit more  
13 texture, I have in the green boxes the definitions  
14 of play and end user from the Copyright Owners'  
15 proposal.

16 A play is defined as the digital  
17 transmission of any portion of a sound recording of  
18 a musical work in the form of an interactive stream  
19 or limited download. And an end user is each unique  
20 individual or entity that has access to the offering  
21 whether by virtue of the purchase of a subscription  
22 to access the offering or otherwise.

23 Q. Now, you understand Spotify offers an  
24 ad-supported service?

25 A. Yes.

1 Q. When you interpret the definition of "end  
2 user," how do you apply that to Spotify's  
3 ad-supported service?

4 A. With Spotify's ad-supported service, any  
5 registered user would have access to the offering.

6 Q. Even though they weren't paying a  
7 subscription price?

8 A. Even though they're not paying a  
9 subscription price and even if they don't access the  
10 service in a particular month, they would be a user  
11 that has access to it.

12 Q. Now, did you analyze the Copyright  
13 Owners' proposal using that definition of an end  
14 user?

15 A. I did it a couple ways. I analyzed the  
16 Copyright Owners' proposal using this definition,  
17 and also using a more restrictive definition,  
18 assuming that it applies only to a measure of active  
19 users.

20 Q. And what definition of active users did  
21 you use for that alternative analysis?

22 A. I used monthly active users, which would  
23 be any -- would count any user that accessed any  
24 portion of a stream at some point during a month.

25 MR. ASSMUS: Your Honor, I need to move

1 into some restricted testimony.

2 JUDGE BARNETT: Good morning. We will  
3 have to briefly close the hearing room to anyone who  
4 is not privy to restricted or confidential  
5 information in this proceeding.

6 (Whereupon, the trial proceeded in  
7 confidential session.)

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1 O P E N S E S S I O N

2 MR. ASSMUS: Just some cleanup on the  
3 prior slides, I'm going to ask them not to put up so  
4 we can stay in open session for a period, and then  
5 I'll go back to restricted section -- session  
6 towards the end.

7 JUDGE BARNETT: Okay, thank you.

8 BY MR. ASSMUS:

9 Q. Okay. First, Dr. Marx, Judge Feder asked  
10 you a question about Demonstrative 10. And I think  
11 he asked you in particular whether Amazon, I think  
12 Amazon Prime Music, was included in the "other"  
13 category in Demonstrative 10.

14 And he asked you if you might take a look  
15 at that. Have you had a chance to take a look at  
16 that?

17 A. Yes, I did. Remember that was  
18 Demonstrative 10. It says across the -- the top of  
19 the -- the title on the top of the figure, estimated  
20 impact of the Copyright Owners' proposal on paid  
21 subscription streaming services and, in parentheses,  
22 (S3).

23 JUDGE FEDER: Yes.

24 THE WITNESS: This graph is only showing  
25 paid subscription services, portable -- portable

1 subscription services mixed use, just the S3  
2 services.

3 JUDGE FEDER: And bundled?

4 THE WITNESS: And that's bundled. But  
5 this is based on Figure 5 on page 10 of my written  
6 rebuttal testimony. And in that figure in the  
7 written testimony, it has Amazon and it has  
8 Spotify's ad-supported service. So that -- that's  
9 there. It's a 200 plus percent increase for Amazon  
10 Prime Music.

11 BY MR. ASSMUS:

12 Q. And I'd also like to direct your  
13 attention, without displaying it back, to  
14 Demonstrative 18, the slide of the effective  
15 per-play rates.

16 A. Yes.

17 Q. And if -- if it was shown that  
18 Dr. Rysman's calculations of the effective per-play  
19 rates with respect to, for example, Google and Apple  
20 were inaccurate and overstated, how would that  
21 affect the positioning of those data points on  
22 Dr. Rysman's graph?

23 A. If they were overstated, then the lines  
24 should come down closer to -- they should come down.

25 Q. And would that also affect your -- your



1 analysis of the effective per-play on a  
2 revenue-weighted basis?

3 A. It would affect the averages. They would  
4 come down as well.

5 Q. And, finally, in terms of cleanup, you  
6 mentioned that your demonstrative slide, I believe  
7 it was 19, was based on HFA data. And what --

8 A. The Services report streams to HFA. And  
9 so this, this slide is based on Dr. Rysman's data,  
10 which I understand to be the streams that were  
11 reported to HFA.

12 Q. And what -- what type of streams are  
13 reported to HFA?

14 A. Spotify reports 30-second and longer  
15 streams to HFA.

16 Q. Okay. If we could have demonstrative  
17 slide 21. You indicated that the Copyright Owners'  
18 economic experts made some errors in analysis of the  
19 greater-of proposal. And I believe you have an  
20 example of that in mind.

21 A. It's not so much that they make errors in  
22 the analysis of it; it's just that they ignore it.  
23 So they look at the comparisons of -- that relate to  
24 the per-stream prong and -- well, focusing on the  
25 per-stream prong and then some mention of per-user

1 prong, but the proposal involves this greater-of  
2 structure.

3           And I just wanted to offer a simple  
4 stylized example to point out that it makes a  
5 difference. And so what this example has is a  
6 low-use service, a hypothetical low-use service that  
7 has 100 subscribers and each subscriber is going to  
8 stream 200 streams per month. And that's a service  
9 that's paying a royalty of 62 dollars per month.

10           Q. And what's the basis for that royalty?

11           A. I'm not assuming any underlying formula.  
12 Just -- just assume, in this example, that's the  
13 royalty they pay.

14           JUDGE BARNETT: What's the rate they're  
15 paying on?

16           THE WITNESS: It doesn't matter.

17           JUDGE BARNETT: Oh, it doesn't matter,  
18 okay.

19           THE WITNESS: Yeah. So whatever formula  
20 was in place, they had to pay 62 dollars.

21           JUDGE BARNETT: Understood.

22           THE WITNESS: And there's a high-use  
23 service with 100 subs, but their subscribers are  
24 streaming 1,200 streams per month. And whatever the  
25 formula is, they're paying 150 dollars per month.

1           In that world, this industry is paying a  
2 total royalty of 212 dollars per month, and if you  
3 divide by the total streams, they're paying .0015  
4 dollars per stream, and they're paying \$1.06 per  
5 subscriber per user.

6           So this industry matches the --  
7 individually, the per-play stream for the Copyright  
8 Owners' proposal and the per-user stream. So you  
9 might think, looking at this, oh, if you impose --  
10 if you make this industry pay the Copyright Owners'  
11 proposal, it shouldn't really have much of an  
12 effect.

13           But that's not right because of the  
14 greater-of aspect. And so if you look at the next  
15 slide, if you apply the Copyright Owners' proposal  
16 to my hypothetical industry, then the low-use  
17 service ends up paying 106 dollars per month,  
18 because they will pay on the per-subscriber prong,  
19 and the high-use service will pay 180 dollars per  
20 month, because they will pay on the per-stream  
21 prong.

22           Combined, then, total royalties go up by  
23 35 percent and the industry as a whole is now paying  
24 .0020, 20 cents, per 100 instead of 15 cents per 100  
25 streams, and paying \$1.43 per user.

1           So I just wanted to illustrate that it's  
2 insufficient to look at the industry and say: Oh,  
3 the Copyright Owners' proposal matches the  
4 per-stream prong on average and matches the per-user  
5 prong on average and so it's okay; it doesn't imply  
6 much of a change to the industry. That's not right.

7 BY MR. ASSMUS:

8           Q.   And if we could go next, if we could skip  
9 to Demonstrative 24. We talked earlier about  
10 Dr. Gans' Shapley-inspired benchmark. Can you  
11 explain your criticisms of that Shapley-inspired  
12 analysis?

13          A.   Yes. So this is Dr. Gans written direct  
14 testimony. What he does in that analysis is that he  
15 assumes that the record labels' Shapley value, their  
16 fair return, is equal to their current profits,  
17 which, as I have noted, are inflated by market power  
18 and other issues.

19               He doesn't model the copyright users at  
20 all, and so he doesn't calculate a Shapley value for  
21 interactive streaming and so doesn't have anything  
22 to say based on this analysis about the appropriate  
23 division of surplus between Copyright Owners and the  
24 interactive streaming services.

25          Q.   Okay. And I do need to go back to

1 restricted session, unfortunately.

2 JUDGE BARNETT: We will be closing the  
3 hearing room to those who are not privy to  
4 restricted information.

5 (Whereupon, the trial proceeded in  
6 confidential session.)

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1 O P E N S E S S I O N

2 BY MR. ASSMUS:

3 Q. And if we could have slide 27. So,  
4 Dr. Marx, turning back to a more holistic view of  
5 this, could you describe for the Panel your view of  
6 the benefits of the current rate structure?

7 A. I discuss in my written rebuttal  
8 testimony a number of benefits of the current rate  
9 structure. One is its adaptability to different  
10 business models, and it allows for differentiated  
11 products serving different customer segments with a  
12 variety of preferences and a variety of willingness  
13 to pay for streaming services.

14 It has efficiency benefits in that it  
15 promotes an all-you-can-eat model of interactive  
16 streaming, which would be efficient in a world with  
17 zero or close to zero cost for an incremental stream  
18 to a subscriber.

19 And streaming has increased the variety  
20 of music listening and introduced a new way for  
21 artists to be discovered. And, finally, the  
22 publishers' and labels' royalty revenues have  
23 increased as interactive streaming has grown.

24 Q. With respect to publishers' revenue  
25 increases, do the higher revenues to publishers

1 themselves have an effect on songwriters or does it  
2 depend on whether or not that revenue is passed  
3 through to songwriters themselves?

4 A. It would depend on whether it's passed  
5 through to the songwriters. And I didn't have a lot  
6 of visibility into the relationship between the  
7 publishers and their songwriters.

8 Q. And then, finally, what do you view as  
9 the problems with the Copyright Owners' proposal,  
10 sort of on a more global basis?

11 A. This is a summary slide. It's my last  
12 slide. And it just lays out the high level, some of  
13 the problems I see with the Copyright Owners' rate  
14 proposal. It represents a large rate increase that  
15 I view as unjustified. It's so high as to make  
16 ad-supported services difficult or impossible to  
17 sustain. And rates for paid subscription services  
18 would more than double.

19 And, in particular, Judge Strickler, you  
20 asked a question about what if there were a  
21 different structure for ad-supported, maybe keeping  
22 percentage-of-revenue there, and the Copyright  
23 Owners' proposal just for subscription. In that  
24 case, the impact would be even larger than this  
25 because once you take out ad-supported, it's the

1 per-stream prong that applies for subscription  
2 services. So I think it brings Spotify's royalties  
3 up to something like 90 percent of their revenue in  
4 that case.

5 It discourages efficiencies in the sense  
6 that it disincentivizes the provision of services  
7 that are targeted to consumers with low willingness  
8 to pay. And it runs counter to an efficient  
9 all-you-can-eat streaming model. And it represents  
10 a substantial change from current practice with  
11 associated disruption to the industry.

12 MR. ASSMUS: Thank you. I'll reserve any  
13 time for redirect.

14 JUDGE BARNETT: Thank you. Mr. Semel?

15 MR. SEMEL: Thank you.

16 JUDGE BARNETT: Is anyone else hearing  
17 the beep or have I just lost my mind?

18 (Discussion off the record.)

19 CROSS-EXAMINATION

20 BY MR. SEMEL:

21 Q. Good morning, Dr. Marx.

22 A. Good morning, Mr. Semel.

23 Q. Soon I'm going to apply for partial  
24 credit for one of your courses.

25 A. Excellent.



1 MR. LANE: Do you want a grade?

2 BY MR. SEMEL:

3 Q. I'd like to start by turning to page 88  
4 of your written rebuttal testimony. It's footnote  
5 245. And you write here, "as I explained in my  
6 written direct testimony, my view is that this 50  
7 cent per-user fee should be removed, which would  
8 mean that standalone portable subscription services  
9 would pay an all-in royalty pool, based on 10 and a  
10 half percent of revenue, 21 percent of sound  
11 recording payments, or 80 cents per user. PRO  
12 payments are deducted from the all-in royalty pool  
13 to determine mechanical royalties."

14 And is that the rate structure that you  
15 believe is the best rate structure available for  
16 this service?

17 A. It's a rate structure that I think would  
18 be consistent with my economic interpretation of the  
19 801(b) factors, which suggests rates that are  
20 somewhat lower than current levels, and if you look  
21 at Services, what they're paying today, Spotify is  
22 the bulk of the industry and currently paying on the  
23 50 cent per-user mechanical floor.

24 So if you were to make an adjustment to  
25 the current structure in a direction of reducing

1 royalties, an obvious choice would be to either  
2 adjust or remove that 50 cent mechanical floor.

3 Q. Thank you. I guess my question was a  
4 little simpler. Is this the best rate structure  
5 that you came up with in analyzing the possible rate  
6 structures in this proceeding?

7 A. I wasn't asked to come up with a rate  
8 structure. I was asked to help the Board to  
9 determine reasonable rates under the 801(b) factors.  
10 And so I provided my economic interpretation of  
11 those factors and the implications of those.

12 I didn't try to do a search for the very  
13 best possible rate structure.

14 Q. So what -- so you don't know if there are  
15 better royalty rate structures available for this  
16 service?

17 A. I think this one would meet the 801(b)  
18 factors. It stays close to current structures and  
19 satisfies other economic interpretations of 801(b)  
20 factors, but I don't know if this is the very best.

21 Q. I guess what I'm trying to get at is what  
22 was the scope that you included? You seem to say --  
23 you say it should be removed, which means you're  
24 comparing it with some other alternative. What was  
25 the pool of alternatives that you looked at in

1 coming up with your opinion that this is what should  
2 happen?

3 A. I was offering the observation that one  
4 adjustment you could make to the current structure  
5 that would stay close to the current structure but  
6 yet move in the direction that is indicated by my  
7 analysis, my economic analysis of the 801(b)  
8 factors, would be to adjust or eliminate that 50  
9 cent per-subscriber floor.

10 Q. And did you consider any other  
11 alternative rate structures besides the current  
12 structure or a structure in which you removed the 50  
13 cent floor?

14 A. I considered the Copyright Owners'  
15 proposal in my written rebuttal testimony.

16 Q. Okay. So we've got those three. So the  
17 current rate structure, removing the 50 cent floor,  
18 and the Copyright Owners' rate proposal. Did you  
19 consider any other potential rate structures in  
20 offering the opinion that what should happen is that  
21 the mechanical floor should be removed?

22 A. In my written direct testimony, I  
23 considered a much broader set of possibilities. For  
24 example, in looking at the first 801(b) factor, I  
25 looked at which rate structures would be most

1 favorable for economic efficiency, and that suggests  
2 that a percentage-of-revenue royalty structure would  
3 be most favorable. That puts you in the position of  
4 thinking about whether there are revenue  
5 mis-measurement issues and perhaps the  
6 appropriateness of back-stops.

7           In this, in the footnote that you're  
8 pointing to, I am referring back to my written  
9 direct testimony where I'm pointing out that one way  
10 to both stay close to current structures, which is  
11 something -- which was my view of the fourth 801(b)  
12 factors, that you might want to try to stay close to  
13 current benchmarks. One way to do that, while  
14 achieving the direction of change that's pointed to  
15 by the other 801(b) factors, is to adjust or  
16 eliminate that 50 cent per-subscriber floor.

17           Q. So I guess, just trying to come back, is  
18 this the best rate structure that you are aware of  
19 for this service?

20           A. Taking into account my economic  
21 interpretation of the 801(b) factors, this, I think,  
22 would be reasonable, and I -- I don't have something  
23 to offer you that I think would dominate it, would  
24 also stay equally close to current structures and  
25 still move in the direction of -- that's pointed to

1 by my analysis of the first, second, and third  
2 801(b) factors.

3 Q. So I just want to be clear. This is the  
4 best rate structure that you are aware of for this  
5 service?

6 MR. ASSMUS: Objection, Your Honor, that  
7 is asked and answered.

8 JUDGE BARNETT: Sustained. She already  
9 said no.

10 MR. SEMEL: She already said no?

11 JUDGE BARNETT: Well, she said she didn't  
12 analyze or try to create another structure.

13 MR. SEMEL: Understood.

14 BY MR. SEMEL:

15 Q. I guess I was trying to get at "aware  
16 of." So I just meant, within the pool that she has  
17 analyzed, this is the best rate structure that you  
18 are aware of? You may not -- there may be another  
19 one you're not aware of, but this is the best rate  
20 structure that you are aware of in your opinion?

21 MR. ASSMUS: I have the same objection,  
22 Your Honor.

23 JUDGE BARNETT: No, that's a refinement.  
24 She can answer that.

25 THE WITNESS: I don't have anything

1 better to offer you right now that would stay  
2 equally close to current structures, yet still be  
3 moving in the direction that's pointed to by my  
4 economic analysis of the first, second, and third  
5 801(b) factors.

6 BY MR. SEMEL:

7 Q. And within these structures, the rates  
8 that you advocated for here, these are the best  
9 rates that you're aware of for this service?

10 A. Again, I'm not sure what you mean by  
11 "best rates." What I mean are rates that are  
12 consistent with the 801(b) factors. The fourth  
13 801(b) factor, I'm interpreting as pushing you to  
14 stay close to relevant benchmarks. And -- and so if  
15 you want to try to stay close to the current  
16 structure, but move it in the direction indicated by  
17 my economic -- economic analysis of the first three  
18 801(b) factors, this is in my view a good choice.

19 Q. Did you analyze whether any improvements  
20 could be made to this rate structure or rate?

21 A. Again, I wasn't tasked with finding the  
22 very best rate structure. I was just trying to be  
23 helpful in providing an economic interpretation of  
24 the 801(b) factors.

25 Q. I'm sorry if I meant to cast aspersions.

1 I just was asking.

2 JUDGE STRICKLER: Well, if I may, you did  
3 actually make one analytical adjustment, right? You  
4 recommend removing the -- the mechanical-only floor,  
5 correct?

6 THE WITNESS: That's right.

7 JUDGE STRICKLER: You did pick that one  
8 as -- as -- in looking -- in looking at the existing  
9 structure and say the existing structure that you  
10 find best among the ones you've seen provided you  
11 make this one change?

12 THE WITNESS: That's right.

13 JUDGE STRICKLER: So you did look at the  
14 rates and decide to make a change?

15 THE WITNESS: Yes. The -- my analysis of  
16 the first -- of all of the 801(b) factors, the  
17 benchmarks, the Shapley value analysis, point in the  
18 direction of moving slightly lower relative to  
19 current rates. If you want to move slightly lower  
20 relative to current rates, the only way to change --  
21 the only way to stay close to current structure and  
22 change the rate that Spotify is -- is paying is to  
23 adjust or remove that 50 cent per-subscriber floor  
24 because that's what they're paying on.

25 JUDGE STRICKLER: Right. So counsel's

1 question, which is what led me to my question, was  
2 did you look at the rates themselves within the  
3 structure and make a determination as to whether  
4 they could be improved. And I think the answer is  
5 with regard to the -- the floor, mechanical-only  
6 floor, the answer is yes, you did.

7 THE WITNESS: Yes.

8 JUDGE STRICKLER: But did you go through  
9 the same process for each element of the -- of the  
10 existing rates or Spotify's proposal and say, yes,  
11 this rate makes sense or, no, this rate does not  
12 make sense? Did you do the same type of -- same  
13 degree of analysis on each element of the structure?

14 THE WITNESS: I did look at the 80 cent  
15 per-subscriber minimum that's in the formula for  
16 portable standalone subscription services, and note  
17 that if you view that as a benchmark -- sorry, as a  
18 back-stop for 10 and a half percent of revenue, then  
19 it is at approximately the correct level.

20 If you view 10 and a half percent of  
21 revenue for a pure-play service like Spotify as  
22 being your target, then 80 cents per subscriber is  
23 about right as a back-stop there. So I -- I noted  
24 that. So the structure, then, that you're left  
25 with, keeping the current -- current structure but



1 making that adjustment to the portable standalone  
2 services mixed-use formula, that stays close to  
3 current structures and moves in the direction  
4 indicated by my economic analysis of the 801(b)  
5 factors. And so I -- I offer that as a possibility  
6 that I think is reasonable and meets the 801(b)  
7 factors.

8 JUDGE FEDER: Sorry, are you finished?

9 JUDGE STRICKLER: Yes.

10 JUDGE FEDER: At a 10 dollar per month  
11 prescription rate, 10 and a half is about a buck 5,  
12 correct?

13 THE WITNESS: There -- the average  
14 per-user revenue for a service like Spotify is \$7.50  
15 a month. Even though that --

16 JUDGE FEDER: Taking into account  
17 discounts and such?

18 THE WITNESS: Yes. So that's -- that's  
19 what's the gap is there. And 80 cents is 10 and a  
20 half percent of \$7.50. So that's why that number  
21 comes out about the same.

22 JUDGE BARNETT: Dr. Marx, did I hear you  
23 say that you were looking at the current structure  
24 and determining if there was some way you could  
25 modify the current rates to make them better, i.e.,

1 to lower the rates?

2 THE WITNESS: My economic analysis of the  
3 801(b) factors, the second, third, and fourth 801(b)  
4 factors led me to look at a Shapley value approach,  
5 which suggests that current royalties are high  
6 relative to a fair division and that, in particular,  
7 musical works royalties are high relative to a fair  
8 division.

9 And when I looked at the benchmarks,  
10 looked at personal digital downloads and CDs, and  
11 looked at the percentage-of-revenue that's being  
12 paid there, streaming royalties are high relative to  
13 those benchmarks.

14 So if you thought that pushes you in the  
15 direction that you might want to lower royalties  
16 somewhat, currently Spotify is paying over  
17 12 percent in musical works royalties. So they're  
18 not paying the 10 and a half percent; they're paying  
19 over 12 percent, because they're paying on that 50  
20 cent mechanical floor.

21 If you remove the 50 cent mechanical  
22 floor, they're still paying something like  
23 11 percent of revenue, but it brings it down closer  
24 to those other benchmarks. They would still pay on  
25 the 80 cent, in 2015, pay on the 80 cent

1 per-subscriber minima.

2 MR. MANCINI: Your Honors, if I may, I  
3 did not want to interrupt the colloquy, but some of  
4 the information is subject to Spotify restricted  
5 information. I don't think we need to close the  
6 courtroom. Perhaps we'll send a letter to correct  
7 the transcript after the fact.

8 JUDGE BARNETT: Okay, thank you. I'm  
9 done with my question. I'm not -- I have nothing  
10 more on that topic. Mr. Semel?

11 MR. SEMEL: Thank you.

12 BY MR. SEMEL:

13 Q. You mentioned just now an 80 cent  
14 per-user rate. And that's -- you're talking about  
15 the one in the portable mixed-use category?

16 A. That's right.

17 Q. And in your written direct testimony,  
18 correct, you describe that as something that  
19 provides protection to the Services, correct?

20 A. There is a place where I talk about it  
21 providing protection to the Services relative to the  
22 percentage of sound recording royalties that it's  
23 paired with in the formula. So without that there,  
24 if you, for example, only had the percentage of  
25 sound recording royalties, then you'd be in a

1 position where the publishers and the sound  
2 recording and the -- and the record labels are the  
3 same firms and they could, by increasing sound  
4 recording royalties, mechanically also increase  
5 their musical works royalties.

6           So it provides protection to the Services  
7 in that sense, that they are less vulnerable to a  
8 manipulation of the sound recording royalties. But  
9 it also provides protection against revenue  
10 mis-measurement for the Copyright Owners.

11           Q. Well, it is in a lesser-than prong,  
12 correct?

13           A. It is. It's in a lessen-than prong  
14 embedded in a greater-than prong, yes.

15           Q. Right. But after -- for someone who  
16 benefits -- for someone who is a copyright owner and  
17 you have a lesser-than prong, right, they'd be happy  
18 to get rid of as many of the parts of the  
19 lesser-than prong as they can, correct? No one  
20 benefits from having an additional prong in the  
21 lesser-than prong, correct?

22           A. The Services would benefit.

23           Q. Correct. The Services would benefit. So  
24 this is not a back-stop for the Copyright Owners';  
25 it's for the Services, correct?

1           A.   No.  It's a -- it's a back-stop relative  
2 to the 10 and a half percent of revenue.  It's in  
3 the greater-than prong.  So the -- with the 80 cent  
4 per revenue in there, the -- if 10 and a  
5 half percent of revenue were to go below 80 cent  
6 per-subscriber, then the 80 cent per-subscriber  
7 would kick in, and so --

8           Q.   Only if the -- sorry.

9           A.   -- it protects the Copyright Owners  
10 against the possibility of revenue mis-measurement.

11          Q.   Just from an economic perspective, do you  
12 agree that from the Copyright Owners' perspective,  
13 it's better off to not have the 80 cents in the  
14 lesser-than prong than to have the 80 cents in the  
15 lesser-than prong?

16          A.   The Copyright Owners would be much worse  
17 off without the 80 cent prong, if there were revenue  
18 mis-measurement because then they would get only 10  
19 and a half percent of mis-measured revenue.  The 80  
20 cents is there to provide protection for the  
21 Services -- okay, let me not opine about why it's  
22 there.

23                   It plays the role that it provides  
24 protection for the Services in case there is revenue  
25 mis-measurement because it is the greater of 10 and

1 a half percent of revenue and another prong.

2 JUDGE STRICKLER: You mean it provides  
3 protection for the Copyright Owners? You said for  
4 the Services.

5 THE WITNESS: Did I say it wrong? I'm  
6 sorry.

7 JUDGE STRICKLER: You said for the  
8 Services.

9 THE WITNESS: Sorry. Thank you.

10 It -- it's playing two roles. It's  
11 embedded in a greater-than structure where it  
12 provides protection to the Copyright Owners against  
13 revenue mis-measurement. It's embedded in a -- in a  
14 lesser-than piece where it provides protection for  
15 the Services against manipulation of the sound  
16 recording royalties.

17 So to characterize it as only being there  
18 for the protection of the Services, I think that's  
19 wrong because it is there to provide a back-stop on  
20 the 10 and a half percent of revenue.

21 BY MR. SEMEL:

22 Q. Well, let me put it another way. If you  
23 removed the 80 cent prong from the lesser-than  
24 formula and left the TCC prong, there is no scenario  
25 in which rates go down as a result of that?

1           A.    I think that's right. Let me just think  
2 through. Now, are you leaving the mechanical floor  
3 in there?

4           Q.    All I'm doing is removing -- it's a  
5 lesser-than prong. So if you remove something from  
6 it, it just means there's one thing that can't drag  
7 down the prong. So I'm just saying if you remove  
8 the 80 cent prong, there's no way you wind up with  
9 lower rates.

10          A.    You get a larger all-in royalty pool, and  
11 now when you subtract the PRO payments, the 50 cent  
12 mechanical floor might no longer bind. And so I  
13 guess mechanical royalties could go down. But I  
14 think we need to be a little bit careful.

15          Q.    But you don't disagree that, in your  
16 written direct testimony, you describe the 80 cent  
17 per-subscriber minimum as something that provides  
18 protection to the Services, correct?

19          A.    I mention that, I recall, but it also  
20 provides protection against revenue mis-measurement,  
21 and I definitely say that in my written direct  
22 testimony as well.

23          Q.    And it operates as a cap on the amount of  
24 -- a cap on the TCC prong, correct?

25          A.    The TCC meaning the percentage of sound

1 recording royalties?

2 Q. Right. The 80 cents operates as a cap  
3 because it is in a lesser-than prong?

4 A. If I'm understanding you correctly, yes.

5 Q. Just going back to the rate structure  
6 that we were talking about that you wrote about in  
7 footnote 245, does your opinion advocate for the  
8 status quo or for a change in the status quo?

9 A. I don't think of myself as advocating one  
10 way or another, but I provide an economic  
11 interpretation of the 801(b) factors. That  
12 interpretation suggests that reasonable royalties  
13 under the 801(b) factors would be somewhat lower  
14 than current levels. It points to the -- that it's  
15 favorable for economic efficiency to use a  
16 percentage-of-revenue structure, and I'm noting that  
17 one way to stay close to current structures but move  
18 in the direction of somewhat lower mechanical  
19 royalties would be to adjust or eliminate the 50  
20 cent mechanical floor.

21 Q. But you know you reference the term  
22 "status quo" over a dozen times in your rebuttal  
23 report; do you know that?

24 A. I didn't count.

25 Q. Does it surprise you?



1           A.   Not particularly.

2           Q.   But you don't know whether you were  
3   advocating for the status quo or not?

4           A.   I'm just offering to the Board the  
5   statement that one way, in my opinion, to meet the  
6   801(b) factors is to avoid disruption by staying  
7   close to current levels and make an adjustment.  
8   There is an adjustment that can be made, the removal  
9   or adjustment of the 50 cent mechanical floor, that  
10   doesn't make much of a change to the current  
11   structure, stays close to the current structures,  
12   but moves you in the direction of somewhat lower  
13   mechanical royalties.

14                   In particular, for Spotify, it would move  
15   them from paying over 12 percent of mechanical  
16   royalties down to paying something like 11 percent.

17           JUDGE STRICKLER:  But if we're concerned,  
18   Dr. Marx, about not being disruptive and, say, we're  
19   just looking at the -- at the fourth factor, 801(b)  
20   factor, keeping the mechanical floor would be less  
21   disruptive because Spotify pays on that at that  
22   level pursuant to that part of the structure, right?

23           THE WITNESS:  Yeah, if you were focused  
24   on not making -- if the -- if the best as far as no  
25   disruption is not to make any change, then that's

1 right. I was trying to stay close to current  
2 relevant benchmarks, while still trying to address  
3 what the other 801(b) factors are pointing towards.

4 JUDGE STRICKLER: How do the other 801(b)  
5 factors apply specifically to support an elimination  
6 of the mechanical-only floor?

7 THE WITNESS: They don't point to, oh, it  
8 is a mechanical-only floor that needs to be removed.  
9 My benchmark analysis and the Shapley value analysis  
10 points to fair and benchmark rates being somewhat  
11 lower than current levels.

12 If you want to make an adjustment that's  
13 going to produce somewhat lower royalties, in an  
14 industry where Spotify is the dominant player and  
15 their subscription streaming service is the dominant  
16 source of revenue, the adjustment that you're going  
17 to have to make is going to have to be one that  
18 affects what Spotify is paying and they pay on that  
19 50 cent per-user prong.

20 So other adjustments that you could make  
21 to different parts of that formula are not going to  
22 change what Spotify is paying. So if you want to  
23 stay close and yet make a difference in what Spotify  
24 is paying for its subscription streaming service,  
25 your only choice is to make an adjustment to that 50

1 cent mechanical floor.

2 JUDGE STRICKLER: So you're saying all of  
3 the four factors taken together in 801(b), in your  
4 opinion, require or justify a lower rate and the  
5 only way you can accomplish that, given where  
6 Spotify pays, which is on the mechanical-only floor,  
7 requires that part of the -- of the structure to be  
8 removed?

9 THE WITNESS: Or adjusted downward,  
10 that's right.

11 JUDGE STRICKLER: Okay. Well, you didn't  
12 propose adjusting downward?

13 THE WITNESS: I did. It's in my written  
14 direct testimony. I agree Mr. Semel has a footnote  
15 here where I say only eliminate, but in my written  
16 direct testimony, I say it would point to it being  
17 adjusted or removed.

18 JUDGE STRICKLER: I know this is your  
19 rebuttal testimony, but do you recall what you said  
20 on direct as to what -- what the mechanical-only  
21 floor should be adjusted downward to?

22 THE WITNESS: I didn't give a number. I  
23 said that if you wanted to push rates down, you need  
24 to push that 50 cent down. And if you moved it all  
25 the way, then you get Spotify down to something like

1 11 percent. But that's -- that's the lever, if you  
2 want to stay close to current structures and still  
3 reduce somewhat the amounts that they're paying.

4 JUDGE STRICKLER: And you would reduce  
5 it, again, not because reducing in its own right is  
6 appropriate but because the Shapley analysis  
7 suggests to you that -- that it should be reduced to  
8 that level?

9 THE WITNESS: That's right, the Shapley  
10 and the benchmarks, the benchmarking against the  
11 percentage-of-revenue and, but PDDs and CDs are  
12 paying.

13 JUDGE STRICKLER: Subpart A analysis?

14 THE WITNESS: That's right.

15 JUDGE STRICKLER: Thank you.

16 JUDGE BARNETT: Dr. Marx, with regard to  
17 disruption, the standard, I believe, is to minimize  
18 the disruptive impact on the structure of the  
19 industry. It's not just disruption to the current  
20 formula.

21 THE WITNESS: I think it's current  
22 industry and I think generally prevailing industry  
23 practices was mentioned there.

24 JUDGE BARNETT: Yes, that's -- that's  
25 right. So is it your opinion that the kinds of

1 changes that are recommended by the Copyright  
2 Owners, proposed by the Copyright Owners, would be  
3 disruptive to the -- clearly, they're -- they're  
4 different from generally prevailing industry  
5 practices, at least in this license arena.

6 Did you look at whether those would be  
7 disruptive to the entire industry?

8 THE WITNESS: Well, I thought about  
9 whether it's disruptive to the structure of the  
10 industry. And as an economist, I would think of  
11 structure as including the cost structure and things  
12 like barriers to entry. And so, clearly, it changes  
13 the cost structure and greatly increases the cost to  
14 these Services.

15 It also puts in place a barrier to entry  
16 in the sense that if you are a new Service, you  
17 might expect to have a period of time where you're  
18 bringing in subscribers, you're starting to get them  
19 to use your service but maybe don't have significant  
20 revenues. You might have a bunch of people starting  
21 with a free trial. In that kind of ramp-up period  
22 under the Copyright Owners' proposal, you're going  
23 to be paying for every stream, for every subscriber,  
24 even through a period of time where you might not  
25 have much or -- or any revenue.

1           So in that sense, it's -- I think it  
2 increases the challenges for an entrant to come up  
3 against that rate structure.

4           JUDGE BARNETT: If you open a restaurant  
5 and start serving food, you have to buy the food  
6 before you can serve the people, right?

7           THE WITNESS: I agree.

8           JUDGE BARNETT: Okay.

9           JUDGE STRICKLER: Building on Judge  
10 Barnett's question -- she took you through the  
11 statute and you added on some parts that were in the  
12 statute as well.

13           But Dr. Eisenach, as you noted in  
14 Demonstrative 14, cites to the -- the CRB's 2009  
15 decision as to what constitutes disruption. And I'm  
16 going to flip through and find his testimony, but he  
17 does -- at least you put it in quotes, I think  
18 you're accurate, he -- he points out that disruption  
19 occurs if you have a substantial -- this is not in  
20 quotation marks, but I think it's correct --  
21 substantial, immediate, and irreversible short-run  
22 impact.

23           So I suppose maybe we can, for the  
24 moment, take you through that because you're now  
25 rebutting the Copyright Owners' proposal. Do you

1 believe the Copyright Owners' proposal would have a  
2 substantial impact?

3 THE WITNESS: Absolutely.

4 JUDGE BARNETT: Why?

5 THE WITNESS: Because it increases  
6 mechanical royalties by many multiples, pushes  
7 existing services to the point where they would be  
8 required to pay more than 100 percent of their  
9 revenues in royalties and likely makes ad-supported  
10 services, which are a substantial portion of the  
11 interactive streaming market, difficult or  
12 impossible to sustain.

13 JUDGE STRICKLER: And do you find that to  
14 be -- to take the next factor that the 2009 decision  
15 relates to -- an immediate impact?

16 THE WITNESS: Seems immediate to me. I  
17 mean, my understanding is that at the moment this  
18 proposal goes in place, we're in a world where the  
19 Services have to figure out a way to come up with  
20 the money to pay royalties greater than their  
21 revenues.

22 JUDGE STRICKLER: We're going to be  
23 setting rates over a five-year term. If that -- if  
24 an increase in rates in the direction of what the  
25 Copyright Owners is proposing would be phased in

1 over time, would you understand that to be less than  
2 an immediate problem to the Services?

3 THE WITNESS: It would be immediately  
4 whatever the first phase is, I guess, but it would  
5 be -- I think the way you're posing it, it would be  
6 immediately a less substantial impact and then  
7 increasing over time.

8 JUDGE STRICKLER: Do you understand that  
9 the Copyright Owners' proposal would be -- would  
10 lead to an irreversible impact?

11 THE WITNESS: I'm not sure. So suppose  
12 the Copyright Owners' proposal goes in place and  
13 Spotify, for example, ends its ad-supported service.  
14 Now suppose in five years, you return to current  
15 structures. Could Spotify reintroduce an  
16 ad-supported service? I suppose they would have  
17 lost the years of investment in developing the --  
18 the stream of advertisers. I mean, it wouldn't be  
19 trivial or costless to do, but I'm not sure I can  
20 characterize it as being completely irreversible.

21 JUDGE STRICKLER: And the last factor is  
22 short-run, but as I look at it, I take short-run to  
23 be essentially synonymous for these purposes as  
24 immediate. So I'm not going to take you through  
25 that factor as well. Thank you.



1 BY MR. SEMEL:

2 Q. Do you believe that the current rate  
3 structure violates the 801(b) factors?

4 A. No.

5 Q. So you believe --

6 JUDGE STRICKLER: Excuse me. So even  
7 having the mechanical-only floor is still consistent  
8 with the 801(b) factors?

9 THE WITNESS: I view it as a benchmark  
10 for 801(b) factors. The -- if I look at 801(b)  
11 factors today, in my analysis, it suggests they  
12 should be adjusted downward somewhat, but I view the  
13 801(b) factors as a benchmark for -- sorry.

14 I view the current rates as a benchmark  
15 for 801(b) factor rates.

16 JUDGE STRICKLER: Counsel's question was  
17 do you think the current rate structure is  
18 consistent with the 801(b) factors, and your answer  
19 was yes. And the current rate structure has the  
20 mechanical-only floor in it. That logically seems  
21 to make it --

22 THE WITNESS: Sorry. Yeah.

23 JUDGE STRICKLER: When you say you're  
24 sorry, do you want to change your testimony or --

25 THE WITNESS: Yes. Let me be more

1 careful. Consistent with the 801(b) factors, so I  
2 think there's a -- it encompasses a range of things  
3 that might be viewed as consistent with the 801(b)  
4 factors. I think the current rates provide a  
5 benchmark for what's consistent with the 801(b)  
6 factors.

7                   When I do my analysis, it suggests that  
8 we can do better at meeting the 801(b) factors by  
9 moving in the direction of pushing downward on that  
10 current benchmark, reducing rates somewhat, but I --  
11 I don't view the current rate structure as being  
12 something that has caused obvious disruption to the  
13 industry or -- or being a problem.

14                   JUDGE STRICKLER: So if I understand your  
15 testimony correctly, you're saying that the current  
16 rate structures satisfies the 801(b) factors but if  
17 you remove the mechanical-only floor, it's a better  
18 fit of the 801(b) factors; is that what you're  
19 saying?

20                   THE WITNESS: That's what I'm saying.

21                   JUDGE STRICKLER: Thank you.

22 BY MR. SEMEL:

23                   Q. So you believe that there is a range of  
24 possible rates that satisfy the 801(b) factors,  
25 correct?

1 A. Rates and structures, yes.

2 Q. And have you analyzed how broad that  
3 range is?

4 A. I used the interpretation of the fourth  
5 801(b) factor as one would want to stay close to  
6 relevant benchmarks, and I think you can stay close  
7 to relevant benchmarks while simultaneously moving  
8 in the direction that's suggested by my analyses of  
9 the 801(b) factors as a whole.

10 Q. I guess my question was a little simpler.  
11 Did you analyze how broad the range of rates are  
12 that might satisfy the 801(b) factors?

13 A. I'm not sure I have a way to quantify  
14 that for you. Certainly, rates that suggest that  
15 Spotify should pay more than 100 percent of its  
16 revenue in royalties would be outside of that range.

17 Q. But you haven't determined the parameters  
18 of the range more precisely?

19 A. I don't have a precise quantification for  
20 you of that.

21 Q. You mentioned in your direct testimony  
22 that none of the analysis that you did relied on  
23 Spotify's sound recording payments. Do you recall  
24 that?

25 A. I recall.

1           Q.    But your -- the rate structure that you  
2 advocate for as the best fit, in fact, the sound  
3 recording payments are the primary back-stop in that  
4 rate structure, correct?

5           A.    In the ad-supported service, it's true  
6 that the sound recording royalties provide the  
7 back-stop there.

8           Q.    Right. So, in fact, your analysis does  
9 rely on Spotify's sound recording payments in  
10 determining what's appropriate?

11          A.    In the analyses that I did related to the  
12 801(b) factors, in those analyses, I'm not using  
13 Spotify's sound recording payments, but you're right  
14 that when I look at the current structure, Spotify's  
15 sound recording payments are in there as a back-stop  
16 for what they're paying for their ad-supported  
17 service.

18          Q.    And you felt that was appropriate?

19          A.    I'm not sure what you're asking me. What  
20 is appropriate?

21          Q.    You felt that it satisfies the 801(b)  
22 factors?

23          A.    It's the current structure, yes.

24          Q.    So did you do any analysis besides saying  
25 because it's the current structure, it -- it

1 satisfies the 801(b) factors or did you look at the  
2 factors themselves and analyze whether they  
3 satisfied the 801(b) factors?

4           A. I looked at the factors, and that -- and  
5 did the analyses in my written direct testimony.  
6 The ad-supported category, the formula there is 10  
7 and a half percent of revenue. So it's a revenue --  
8 percent-of-revenue structure.

9           The back-stop there is based on the sound  
10 recording royalty payments. And I view that as  
11 reasonable because there are practical  
12 considerations here. In particular, for an  
13 ad-supported service, the definition of a user,  
14 there are some challenges associated with that  
15 because you can have, as we saw in the calculations  
16 that I did, registered users; you might register and  
17 then disappear from the service for a long period of  
18 time.

19           With a subscription, a paying user,  
20 they're there paying, you can count them each month.  
21 And how to appropriately count users for an  
22 ad-supported service is more challenging. And so  
23 taking into account practical considerations, I  
24 think it's reasonable the way that category is set  
25 up with a back-stop based on a percentage of sound

1 recording royalties.

2 Q. All right. So you believe that sound  
3 recording -- a percentage of sound recording  
4 royalties is a fair way of calculating royalties  
5 under the 801(b) factors, correct?

6 A. I think in the particular case of  
7 ad-supported services, it offers a reasonable way to  
8 derive a back-stop for the percentage-of-revenue  
9 calculation, given the practical consideration that  
10 it is challenging to count users for an ad-supported  
11 service.

12 Q. Okay. Just to be clear, because I used  
13 the word "fair" and you used the word "reasonable."  
14 Is there a difference in your mind between fair and  
15 reasonable?

16 A. I'm an economist. And so fair is a -- is  
17 a tough one for me because it doesn't have a unique  
18 definition in economics. So I was intentionally not  
19 using your word "fair."

20 I -- I gave fair a particular economic  
21 interpretation in my written direct testimony of the  
22 Shapley value. So I was trying to be clear there  
23 about how I was using the word.

24 Q. But under the 801(b) factors they also  
25 use the word "fair," correct?

1           A.    Oh, yes, they do.  That's why I felt the  
2   need to give the 801(b) factors a specific economic  
3   interpretation before I had something to offer to  
4   the Panel about how to interpret them.

5           Q.    And -- and you determined that a  
6   percentage of sound recording payments was fair  
7   using whatever interpretation you used of the 801(b)  
8   factors?

9           A.    No.  The -- the Shapley value approach  
10   that I used as the interpretation for fair tells you  
11   something about the level of payments.  It's not  
12   specific about a rate structure.  It just tells you  
13   about how the revenues should be divided up among  
14   the various parties.

15                   Now, it's true that in -- in the Shapley  
16   value setting, if revenues increased, it would  
17   require that royalties also -- royalty payments, the  
18   dollar amounts paid upstream, would also increase.  
19   And so a percentage-of-revenue rate structure is  
20   consistent with the Shapley value view of fairness.  
21   And a per-subscriber or per-play payment is not  
22   consistent with the fairness requirements of a  
23   Shapley value.

24                   For example, if Services were able to  
25   price-discriminate among high-willingness-to-pay

1 users more effectively, if TIDAL is willing to get  
2 subscribers paying 20 dollars per month for a  
3 high-fidelity service, that would be additional  
4 revenue. Might not be any more users, might not be  
5 any more streams, but it would be additional  
6 revenue.

7           The fairness criteria as interpreted  
8 through the Shapley value says they should pay more  
9 royalties. They've got this additional revenue for  
10 the use of music, and they should share some of that  
11 upstream. That doesn't happen with a per-stream or  
12 per-user structure like the Copyright Owners'  
13 structure.

14           So with the Shapley value interpretation  
15 of fairness, a percentage-of-royalty rate structure  
16 is fair for that criteria, and the Copyright Owners'  
17 proposal is not.

18           Q.    Okay. I'll try and go about this a  
19 different way.

20           Do you believe that Spotify's rate  
21 proposal is fair under the 801(b) factors?

22           A.    I didn't analyze Spotify's -- all the  
23 details of Spotify's rate proposal.

24           Q.    So you don't know whether Spotify's rate  
25 proposal is fair under the 801(b) factors?



1           A.    Spotify's rate proposal is consistent  
2   with the 801(b) factors in the sense that it  
3   proposes to eliminate the 50 cent per-subscriber  
4   mechanical floor, but Spotify's rate proposal also  
5   involves some adjustments to the definition of  
6   revenue and to the definition of subscribers that I  
7   didn't analyze.

8                    I wasn't asked to analyze Spotify's  
9   proposal as a whole, and that's not what I did.

10          Q.    Right.  So just to be clear, your  
11   opinions do not include the opinion that Spotify's  
12   rates and terms are fair?

13          A.    My opinion is that the adjustment that  
14   Spotify has in its proposal, that is, to remove the  
15   50 cent mechanical floor, that fits with my view of  
16   the 801(b) factors and so fair within my  
17   interpretation of fairness, within the 801(b)  
18   factors.

19                   There are other things in Spotify's  
20   proposal that I didn't explore.

21          Q.    So just to try to make my question a  
22   little clearer, your opinions do not include the  
23   opinion that, as a whole, Spotify's proposed rates  
24   and terms are fair?

25                   MR. ASSMUS:  Objection, that's asked and

1 answered.

2 JUDGE BARNETT: Overruled.

3 THE WITNESS: I'm not sure I can answer  
4 that. I haven't delved into some aspects of  
5 Spotify's proposal. I have looked at the aspect of  
6 it that is to remove the 50 cent mechanical floor.  
7 And that is consistent with my view of the 801(b)  
8 factors.

9 But I haven't -- I wasn't asked to look  
10 at their proposal, and I didn't look at certain  
11 aspects of it. So I'm not in a good position to  
12 have an opinion about that.

13 BY MR. SEMEL:

14 Q. I actually wasn't asking you to make up  
15 an opinion on the spot. I was just trying to  
16 clarify that your opinions that you've offered in  
17 this case do not include the opinion that, as a  
18 whole, Spotify's proposed rates and terms are fair?  
19 And I believe you -- your answer seems to be yes,  
20 but I'm just trying to clarify that.

21 A. When you say "as a whole," you mean  
22 considering all aspects of their proposal?

23 Q. Yes, the proposal as a whole, like is  
24 this proposal as a whole fair?

25 A. There are parts of it that I didn't

1 analyze, so I did not reach an opinion about that.

2 Q. Okay, thank you.

3 MR. SEMEL: I'm probably going to do a  
4 restricted session now, so I don't know if you want  
5 to break.

6 JUDGE BARNETT: Yes. Let's be at recess  
7 until 1:00 o'clock or five after.

8 (Whereupon, at 12:06 p.m., a lunch recess  
9 was taken.)

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1 AFTERNOON SESSION

2 (1:14 p.m.)

3 JUDGE BARNETT: Please be seated.

4 Mr. Semel, did you want to start with  
5 restricted information?

6 MR. SEMEL: I think that's right.

7 JUDGE BARNETT: Those of you in the  
8 courtroom who are not permitted to hear confidential  
9 business information in this proceeding, please wait  
10 outside.

11 (Whereupon, the trial proceeded in  
12 confidential session.)

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1 O P E N S E S S I O N

2 JUDGE BARNETT: What were you saying?

3 MR. ASSMUS: Very brief redirect, Your  
4 Honor, and then I would like to address some  
5 exhibits I neglected to address during my direct on  
6 her rebuttal. We need to come up for a new word for  
7 direct on rebuttal.

8 REDIRECT EXAMINATION

9 BY MR. ASSMUS:

10 Q. Dr. Marx, you recall just now you and Mr.  
11 Semel discussed this concept of rates for long play  
12 songs?

13 A. Yes.

14 Q. Did you in connection with your analysis  
15 of the PDD benchmark do an adjustment for long  
16 plays?

17 A. Yes, I did.

18 Q. And do you recall the level of that  
19 adjustment in terms of a percentage?

20 A. I had an estimate of the percentage of  
21 songs that were above five minutes and used an  
22 estimate of how much above five minutes those songs  
23 were on average and applied the incremental payment  
24 per minute for songs above five minutes.

25 Q. And did that end up being a very big

1 adjustment?

2 A. It wasn't a big adjustment. It was -- it  
3 went from 9.1 cents per stream to, I think, 9.6  
4 cents.

5 Q. And based on that could an adjustment for  
6 long plays in the HFA data have anywhere near the  
7 effect of the difference you saw between 30 second  
8 streams and all streams?

9 A. No.

10 Q. One final question. We have talked a lot  
11 about Spotify's ad-supported service and its impact  
12 on Spotify were it to close.

13 Would it be good for consumers if Spotify  
14 was to shut down its ad-supported service?

15 A. It would be bad for the roughly half of  
16 the consumers that are streaming consumers who are  
17 using the ad-supported service. If that's their  
18 choice, it wouldn't be there any more.

19 MR. ASSMUS: Nothing further on redirect,  
20 Your Honor.

21 And I just wanted to address some of the  
22 exhibits.

23 JUDGE BARNETT: Okay.

24 MR. ASSMUS: There are just a handful of  
25 exhibits that we are admitting for the truth of the

1 matter asserted. I have given that list to Mr.  
2 Semel. The ones that are not yet admitted that were  
3 in our binders are Trial Exhibits 731, 1013, 2597  
4 and 2598. Those are all in agreement.

5 MR. SEMEL: We have objection.

6 JUDGE BARNETT: Those are admitted.

7 (Google Exhibit Number 731 was marked and  
8 received into evidence.)

9 (Pandora Exhibit Number 1013 was marked  
10 and received into evidence.)

11 (Copyright Owners Exhibit Numbers 2597  
12 and 2598 were marked and received into evidence.)

13 MR. ASSMUS: And then we took a page out  
14 of the Copyright Owners' playbook, which I think  
15 took a page out of ours in terms of an index, but we  
16 have in the binder a list of the reliance exhibits  
17 starting on the second page of the binder.

18 I am happy to read those into the record  
19 or hand them to the clerk afterwards for recording  
20 them as admitted. I don't know if Mr. Semel has any  
21 objection to entry of any of those on a reliance  
22 basis only.

23 MR. SEMEL: No, in this category we have  
24 of not for the truth, no.

25 JUDGE BARNETT: Okay.

1 THE CLERK: I have a preference if you  
2 could read them.

3 MR. ASSMUS: Absolutely. It helps us  
4 later in the record when we want to do a search, so  
5 I will read them as quickly as I can without too  
6 quickly. They are Exhibits 55, 62, 246, 846, 867,  
7 887, 973, 1000, 1001, 1003, 1005, 1007, 1009, 1010,  
8 1012, 1015, 1017, 1018, 1019, 1028, 1029, 1030, and  
9 then 1034 through 1038 inclusive, and 1041, 1042,  
10 1043, 1598, and I think I am at a big range here,  
11 1741 through 1752 inclusive, 2805, 2817, 2896, 3118,  
12 3121 and 3359.

13 JUDGE FEDER: Mr. Assmus, could you check  
14 your list? Did you mean to say 1005 to 1007 or 1005  
15 and 1007?

16 MR. ASSMUS: I meant to and hope I did  
17 say 1005 and 1007.

18 JUDGE FEDER: Okay. Thanks. Thank you.

19 JUDGE BARNETT: Thank you. Anything  
20 further then? Those are received.

21 (Amazon Exhibit Numbers 55, 62, 246 were  
22 marked and received into evidence.)

23 (Google Exhibit Number 846 and 867 were  
24 marked and received into evidence.)

25 (Pandora Exhibit Numbers 887, 973, 1000,



1 1001, 1003, 1005, 1007, 1009, 1010, 1012, 1015,  
2 1017, 1018, 1019, 1028, 1029, 1030, 1034 through  
3 1038, 1041, 1042, 1043 were marked and received into  
4 evidence.)

5 (Apple Exhibit Number 1598 was marked and  
6 received into evidence.)

7 (Copyright Owners Exhibit Numbers 1741  
8 through 1752, 2805, 2817, 2896, 3118, 3121, 3359  
9 were marked and received into evidence.)

10 JUDGE BARNETT: Dr. Marx, you may be  
11 excused.

12 THE WITNESS: Thank you.

13 JUDGE BARNETT: Thank you.

14 MR. ZAKARIN: Housekeeping?

15 JUDGE BARNETT: Oh, I love housekeeping.  
16 Mr. Zakarin.

17 MR. ZAKARIN: I'm going back to it for a  
18 day.

19 Last week, and it was pursuant to Your  
20 Honor's order, we had -- we designated portions of  
21 the record from 2008 relating to Mr. Quirk and Mr.  
22 Sheeran and provided that to the Services. And they  
23 were instructed to make their counterdesignations by  
24 today, which they have done.

25 And we will, I think coordinate as to

1 whether this gets submitted to Your Honor as one,  
2 you know, full designation along with the portions  
3 of the testimony or whether it comes in separately.  
4 I would hope it comes in just together with the  
5 pages designated, but I will allow my colleagues to  
6 work that out together with the Services.

7 JUDGE BARNETT: Thank you.

8 MR. ZAKARIN: I wanted to let you know we  
9 will get that to Your Honors very quickly.

10 MR. WEIGENBERG: Right. And I think,  
11 Your Honors, I suspect even if it comes in  
12 separately, I have looked at what I believe, it  
13 should be clear, and we will file it simultaneously.  
14 I think it will be clear either way.

15 JUDGE BARNETT: Thank you.

16 MR. ZAKARIN: It is relatively confined,  
17 happily.

18 JUDGE BARNETT: Thank you. Mr. Mancini?

19 MR. MANCINI: Your Honors, one other  
20 housekeeping matter. I believe all counsel have  
21 indicated that of the dates suggested by the Panel  
22 for closing, that June 7th works for all counsel, if  
23 that is still convenient for the Panel.

24 JUDGE BARNETT: That will work.

25 MR. MANCINI: Thank you.

1                   MR. SEMEL: Just because I didn't want to  
2 get left out of the housekeeping, you had indicated,  
3 Your Honor, the other day with regard to the  
4 findings of fact and conclusions of law the idea  
5 that reply briefs should be numbered to match, which  
6 I think is a great idea.

7                   We began talking with the Services and  
8 will continue, but it occurs to me that Your Honors'  
9 preferences on this are probably something we should  
10 know upfront.

11                   Our concern is with receiving five  
12 different sets that we would have to respond to with  
13 five -- and the coordination. So our preference is  
14 for a consolidated set of numbered findings of fact  
15 and conclusions of law from one side and obviously  
16 we would provide that to match.

17                   We will continue talking with them about  
18 their preferences, but I thought I would raise it in  
19 case Your Honors know what you want and would tell  
20 us.

21                   JUDGE BARNETT: It occurred to me that we  
22 would have many on one side and one on the other,  
23 and we would probably have more than one paragraph  
24 1, et cetera.

25                   MR. SEMEL: If I might --

1 JUDGE BARNETT: I doubt that the Services  
2 are going to be willing to consolidate, but if they  
3 are, all the better. If they are not, then, you  
4 know, AM for Amazon, AP for Apple, et cetera, to  
5 designate the paragraphs?

6 MR. SEMEL: Understood. The only thing I  
7 would just add is just from our coordination side is  
8 obviously if they are submitting five separate full  
9 sets, which could be 500 pages each, and we're  
10 submitting one set they are responding to one, it is  
11 sort of a 25-fold increase of work and paperwork on  
12 our side.

13 And --

14 JUDGE STRICKLER: Well, five fold  
15 increase.

16 MR. SEMEL: If they are splitting up ours  
17 -- I guess it could be a five-fold or 25-fold thing  
18 depending on how they coordinate their reply.

19 JUDGE STRICKLER: It is a lot more paper.

20 MR. SEMEL: It is a lot more paper.

21 JUDGE STRICKLER: Fair enough.

22 MR. SEMEL: That's why I thought that it  
23 would be -- partly for Your Honors, that it could be  
24 5- or 7,000 pages if we have to respond to full sets  
25 of each.

1 JUDGE BARNETT: This is a very complex  
2 case with lots -- I mean, all of these rate-setting  
3 cases are complicated. And there are lots of issues  
4 to be covered, but in my humble opinion, if anybody  
5 is handing in 500 pages of proposed findings and  
6 conclusions, they are risking me not looking at  
7 them. I mean, seriously. That's outside the realm  
8 of reality.

9 But with regard to the coordination, I  
10 think it would be delightful. And we would like it.  
11 Let me talk with my colleagues and see if we will  
12 order it or if we will just encourage it.

13 JUDGE STRICKLER: Did you have some idea,  
14 Mr. Semel, as to how to make your life easier with  
15 regard to that, if they don't can combine their  
16 proposed findings?

17 MR. SEMEL: I guess our initial thought  
18 would be that at a minimum it would be a  
19 consolidated numerical number, so that we don't have  
20 overlapping numbers. We would hope that they would  
21 also coordinate a central, since they put in joint  
22 witnesses and joint exhibit list, they would  
23 coordinate a joint section as well, so we're not  
24 getting literally five sets of the same findings of  
25 fact.

1                   And then beyond that, I would expect or  
2 hope Your Honors would be okay with us, if that  
3 worse case scenario happens, and we wind up with  
4 five sets of almost identical findings of fact that  
5 we would do sort of see A, see B, rather than have  
6 Your Honors have to reread our replies for each one.

7                   Again, now we're treading on an area that  
8 I think you probably have as much of a care about as  
9 we do. Whether we are cut and pasting the same  
10 response five times that you have to read five times  
11 or whether you would rather see us reference you to  
12 a master list.

13                   My preference would be consolidate on  
14 their side, consolidate on our side and answer.

15                   JUDGE STRICKLER: Have you talked to them  
16 about this yet or no?

17                   MR. SEMEL: We did. We began the  
18 conversation. I just wanted to raise it because I  
19 was -- why spend our time coordinating if you are  
20 going to tell us what you want. But we will  
21 continue to talk.

22                   JUDGE BARNETT: Mr. Marks?

23                   MR. MARKS: Let me just offer Pandora's  
24 position, which is that we will -- we oppose any  
25 requirement that we consolidate our post-trial

1 findings with any of the other Services. To the  
2 extent that we do have some joint witnesses with  
3 others, of course we will try to economize, and we  
4 all have some interest in economizing, but some of  
5 the witnesses are sponsored by some groups of us,  
6 some are by a broader group of us, and many are  
7 different. We have differences in our proposals,  
8 and the like.

9 I think we will all coordinate to the  
10 extent that we can, and to the extent it is  
11 appropriate, but that I doubt that Mr. Semel is  
12 talking -- we would oppose any requirement that we  
13 coordinate, but we will minimize the burden on  
14 ourselves and on the Panel.

15 JUDGE BARNETT: What I can say is there  
16 is no need for anybody to cite as a finding of fact  
17 that, you know, the current regs were adopted by  
18 agreement in 2012 or any of the -- I mean, really.  
19 We know all that stuff.

20 The facts need to relate simply to the  
21 evidence presented in this proceeding. We don't  
22 need you to cite the statute to us as a finding of  
23 fact or a conclusion of law. Get to the meat of it.

24 MR. MARKS: Understood, Your Honor.

25 JUDGE BARNETT: But with regard to the

1 rest of it, we will have to talk, obviously.

2 MR. ASSMUS: In case the record is not  
3 clear, I will just start, Spotify likewise objects  
4 to any order requiring consolidation. The  
5 coordination cost, the differences in proposals as  
6 they may evolve, just even client signoff becomes  
7 really impossible with respect to a coordinated  
8 filing. Even for the ones we have done on joint  
9 witnesses, it has been difficult.

10 JUDGE BARNETT: Understood.

11 MR. ELKIN: Amazon concurs.

12 MR. STEINTHAL: We do too.

13 MS. MAZZELLO: Apple as well, if anyone  
14 wanted it.

15 JUDGE BARNETT: Got it. Speaking of five  
16 to one.

17 JUDGE FEDER: I think we're expecting  
18 some briefing from you, am I right on that? I seem  
19 to recall that we're expecting some briefing on a  
20 few issues? Am I correct on that understanding or  
21 am I hallucinating?

22 MR. SEMEL: I will say we intend at the  
23 end of this, we were going to work on it this  
24 weekend, we intend to get you some brief briefing on  
25 some evidentiary issues that have been raised and we



1 will keep it as tight as we can.

2 MR. ZAKARIN: Maybe I was wrong. I  
3 thought maybe what you may have been referring to is  
4 the issue related to the Spotify/UMG contract.  
5 Unless I was wrong, and on that you wanted, there  
6 was going to be a letter brief coming in to -- I  
7 think one came yesterday, yours, and ours either has  
8 gone in or is going in today.

9 JUDGE FEDER: That was one I think we  
10 were also going to get something relating to the  
11 data that came in.

12 MR. SEMEL: Yes, that's the motion. This  
13 weekend we're going to work on that and get that to  
14 you.

15 MR. MANCINI: The only thing I would add  
16 to that, Your Honors, I believe we were going to  
17 meet and confer on a schedule for that. We haven't  
18 heard what that schedule is.

19 MR. SEMEL: We will figure it out.

20 JUDGE BARNETT: Thank you. Is there  
21 anything else we can do today? Any witnesses we can  
22 call? Anybody know how to adjust the temperature in  
23 the room? We can work on that.

24 Okay. Thank you all. We will be at  
25 recess. Wait. Mr. Steinthal?

1           MR. STEINTHAL: One other housekeeping, I  
2 suppose. When can we expect, if we're going to get  
3 it, the rulings on the motions in limine, simply  
4 because that will impact how we brief things? So  
5 just wanted to raise that.

6           JUDGE BARNETT: We're going to talk about  
7 how we're going to split up that workload as well as  
8 some other things that are sitting in our offices in  
9 other matters that needs to be addressed.

10          MR. ASSMUS: There are other matters?

11          JUDGE BARNETT: Did you say there are no  
12 other matters?

13          MR. ASSMUS: There are other matters?

14          JUDGE BARNETT: Yeah, minor things. So  
15 our hope is sooner rather than later. I can't give  
16 you a date. They are under advisement.

17          MR. STEINTHAL: Understood.

18          JUDGE BARNETT: Thank you. We are at  
19 recess until 9:00 clock Monday morning -- no, sorry,  
20 9:00 o'clock Wednesday morning.

21                 (Whereupon, at 2:26 p.m., the hearing  
22 recessed, to reconvene at 9:00 a.m. on Wednesday,  
23 April 12, 2017.)

24

25

## 1 C O N T E N T S

2 WITNESS DIRECT CROSS REDIRECT RECROSS

3 LESLIE MARX

4 5478 5570 5653

5

6

7 AFTERNOON SESSION: 5606

8

9 CONFIDENTIAL SESSIONS: 5486-5557,

10 5565-5567, 5607-5652

11

## 12 E X H I B I T S

13 EXHIBIT NO: MARKED/RECEIVED REJECTED

14 AMAZON

15 55 5656

16 62 5656

17 246 5656

18 GOOGLE

19 731 5655

20 846 5656

21 867 5656

22 PANDORA

23 887 5656

24 973 5656

25 1000 5656

	EXHIBIT NO:	MARKED/RECEIVED	REJECTED
2	PANDORA		
3	1001	5657	
4	1003	5657	
5	1005	5657	
6	1007	5657	
7	1009	5657	
8	1010	5657	
9	1012	5657	
10	1015	5657	
11	1017	5657	
12	1018	5657	
13	1019	5657	
14	1028	5657	
15	1029	5657	
16	1030	5657	
17	1034 through 1038	5657	
18	1041	5657	
19	1042	5657	
20	1043	5657	
21	APPLE		
22	1598	5657	
23	COPYRIGHT OWNERS		
24	1741	5657	
25	1742	5657	

1	EXHIBIT NO:	MARKED/RECEIVED	REJECTED
2	COPYRIGHT OWNERS		
3	2597	5655	
4	2598	5655	
5	2805	5657	
6	2817	5657	
7	2896	5657	
8	3118	5657	
9	3121	5657	
10	3359	5657	
11	COPYRIGHT OWNERS	MARKED FOR ID ONLY	
12	5021	5640	
13	5022	5648	
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## 1 CERTIFICATE

2

3 I certify that the foregoing is a true and  
4 accurate transcript, to the best of my skill and  
5 ability, from my stenographic notes of this  
6 proceeding.

7

8

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4/10/17Dea Bynter

10 Date

Signature of the Court Reporter

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CD-R

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Date: 4/7/17

Case: Rates and Terms (Phonorecords III)  
Pages: 5473 through 5670  
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